STATE OF MICHIGAN
IN THE SUPREME COURT

NATIONAL WINE & SPIRITS, INC.
NWS MICHIGAN, INC., and
NATIONAL WINE & SPIRITS, L.L.C.,

Plaintiff-Appellants,

v

STATE OF MICHIGAN,

Defendant-Appellee,

And

MICHIGAN BEER & WINE
WHOLESALERS ASSOCIATION,

Intervening Defendant-Appellee.

Supreme Court No. 126121

Court of Appeals No. 243524

Circuit Court for the County of Ingham
No. 02-13-CZ

BRIEF OF INTERVENING DEFENDANT-APPELLEE MICHIGAN BEER & WINE WHOLESALERS ASSOCIATION

ORAL ARGUMENT REQUESTED

Respectfully submitted by,

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COUNTER-STATEMENT OF QUESTIONS PRESENTED

I. **WHERE APPELLANTS HAVE BEEN ABLE TO ENTER THE MICHIGAN MARKET AS BOTH AN AUTHORIZED DISTRIBUTION AGENT (ADA) OF SPIRITS AND AS A WINE WHOLESALER AND ARE TREATED THE SAME AS ANY SIMILARLY SITUATED MICHIGAN RESIDENT AND THERE IS NO EVIDENCE OF DISCRIMINATION AGAINST OUT-OF-STATE PRODUCTS OR INTERFERENCE WITH THE FLOW OF INTERSTATE COMMERCE, DID THE COURT OF APPEALS COMMIT REVERSIBLE ERROR WHEN IT, LIKE THE TRIAL COURT, REJECTED A DORMANT COMMERCE CLAUSE CHALLENGE TO A STATUTE THAT CONCERNS THE STRUCTURE OF MICHIGAN'S ALCOHOLIC BEVERAGE DISTRIBUTION SYSTEM?**

Plaintiffs-appellants say "yes".

Trial Court says "no".

Court of Appeals says "no".

Appellees say "no".

Intervening appellee says "no".

II. **DID THE COURT OF APPEALS COMMIT REVERSIBLE ERROR WHEN IT AFFIRMED THE TRIAL COURT'S GRANT OF SUMMARY DISPOSITION TO DEFENDANT ON THE EQUAL PROTECTION CHALLENGE TO A STATUTE THAT ADDRESSES THE STRUCTURE OF THE DISTRIBUTION SYSTEM FOR ALCOHOLIC BEVERAGES WHERE THE STATUTE IS RATIONALLY RELATED TO A LEGITIMATE STATE INTEREST IN THE STRUCTURE OF ITS "UNQUESTIONABLY LEGITIMATE" ALCOHOLIC BEVERAGE DISTRIBUTION SYSTEM?**

Plaintiffs-appellants say "yes".

Trial Court says "no".

Court of Appeals says "no".

Appellees say "no".

Intervening appellee says "no".

COUNTER STATEMENT OF FACTS

Rather than making an unbiased presentation of the facts with citation to the lower court record, appellants give a lop-sided rendition of their opinions[1] and their citation to the lower court record is spotty and selective.[2] Therefore, intervening defendant Michigan Beer & Wine Wholesalers Association (MB&WWA) is compelled to offer the following counter-statement of facts.

In January 2002, National Wine & Spirits, Inc., NWS Michigan, Inc., and National Wine & Spirits, L.L.C. (hereinafter collectively referred to as "appellants"), filed a Complaint

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[1] An example of this can be seen in footnote 12 at page 8 of appellants' brief, where they claim that "dualing" of wine wholesalers is the "norm" in Michigan. There is no citation to the lower court record for support of that contention – which, in fact, is wrong. *See* Appellants' Appendix, p 53a, Lashbrook Aff., at ¶ 7, which was introduced into the record, was never rebutted, and which refutes appellants' statement. Other examples of unsupported opinions can be seen on page 8 of appellants' brief, where they state that they "believe" that in-state ADAs "encouraged the Legislature to discriminate" against them without any citation to the record or support of that allegation -- which is obviously refuted by the fact that appellant became an ADA immediately with the creation of that position.

[2] Another stark example of misleading statements can be found in the chart set out at page 2 of appellants' brief. Appellants list four categories of wholesalers or ADA/ wholesalers and say that there are "no out-of-state companies or individuals in any" of three classes (i.e., pre-1996 wholesaler, post-1996 wholesaler, and pre-1996 ADA/ wholesaler), implying that only the fourth category (post-1996 ADA/wholesaler) is made up of only out-of-state companies. But the record does *not* support that statement. In fact, two of the appellants (who are jointly a "post-1996 ADA/wholesaler") *are Michigan companies.* If the chart on page 2 of the brief were accurate, it would show *all* four categories of ADAs and wholesalers consist of Michigan companies. The chart is also incorrect when it has a category for "pre-1996 ADA/wholesalers". Since ADAs did not exist before 1996, there is no such category; before 1996 there were only wholesalers. Finally, the chart is incorrect when it states that pre-1996 ADA/wholesalers can "dual" but post-1996 ADA/wholesalers cannot dual. In fact, no one who is an ADA and a wholesaler can dual (except for those brands they were already distributing prior to September 24, 1996, a time when ADAs did not exist, or where they acquire pre-existing distribution rights by purchase, merger or acquisition).

for Declaratory Judgment (the "Complaint") against the State of Michigan. (MB&WWA Appendix, p 1b.)

The Complaint described the appellants as follows:

> "1. National Wine & Spirits, Inc. is an Indiana corporation with its principal place of business in Indianapolis, Indiana.
>
> 2. NWS Michigan, Inc. is a wholly owned subsidiary of National Wine & Spirits, Inc.
>
> 3. NWS Michigan, Inc. became incorporated in Michigan on October 21, 1996 and became an Authorized Distribution Agent of spirits for the State of Michigan on or about December 22, 1996.
>
> 4. National Wine & Spirits, L.L.C. is also a wholly owned subsidiary of National Wine & Spirits, Inc.
>
> 5. National Wine & Spirits, L.L.C. became incorporated in Michigan on December 21, 1998 and became a licensed wine wholesaler in the State of Michigan on or about November 12, 1999." (MB&WWA Appendix, p 2b).

The Complaint sought a declaration that § 205 of the Michigan Liquor Control Code (the "Code"), MCL 436.1205(3) ("§ 205(3)") violates the Equal Protection clauses of the United States and Michigan Constitutions and that it violates the Commerce Clause of the U.S. Constitution. The challenged statute deals with how Michigan has chosen to distribute and warehouse spirits that the state owns. The complaint also challenges how the state structures its wine distribution system.

The State of Michigan denied any constitutional violation. (Appellants' Appendix, p 23a, State's Answer.)

In April of 2002, before any discovery was done and before any scheduling order had been entered by the trial court, appellants filed a Motion for Summary Disposition on their Equal Protection count.

On April 17, 2002, MB&WWA filed a motion to intervene asserting that it represents 75% of the licensed wholesalers in Michigan and that its members accounted for approximately 90% of total sales of wine in the State. (MB&WWA Appendix, p 11b.) MB&WWA indicated that 34 of its wine wholesalers were not Authorized Distribution Agents ("ADAs") and that they would suffer harm if § 205(3) were held unconstitutional. (*Id.*)

An order granting intervention was entered on May 9, 2002. (MB&WWA Appendix, p 17b.)

The State and MB&WWA filed briefs in opposition to Appellants' Equal Protection challenge to the statute. MB&WWA's brief set forth the legislative history of § 205.[3] MB&WWA's brief had attached to it the affidavit of Michael Lashbrook, President of MB&WWA (hereinafter "Lashbrook Aff.", Appellants' Appendix, p 52a) and the affidavit of Mr. Nicholas Pavona, Vice President of a wine wholesaler who is not an ADA. (MB&WWA Appendix, p 19b). The state proffered the affidavit of Julie Wendt, Director of Licensing for the Michigan Liquor Control Commission. (MB&WWA Appendix, p 22b).

The affidavits of Lashbrook, Pavona and Wendt were never challenged by appellants or rebutted. The Wendt affidavit, among other things, confirmed that as of 2002, Michigan had over 300 licensed outstate sellers of wine (i.e., the entities who import wine into Michigan for distribution by wholesalers) and that between September 24, 1996 and April 30, 2002, approximately 143 new outstate sellers of wine licenses had been issued --

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[3] MB&WWA's Brief in Response to Plaintiffs' Motion for Summary Disposition and Request for Summary Disposition pursuant to MCR 2.116(I) (dated May 1, 2002) explained the legislative history of what became § 205 of the Liquor Control Code. For the Court's convenience, pages 6 through 9 of that Brief setting forth the legislative history and Exhibits No. 1C, D, E, F and G are set out in MB&WWA's Appendix, starting at p 24b.)

confirming that new wines (through new outstate sellers) are continuously coming into the market. (See Wendt affidavit, MB&WWA Appendix, p 22b).

Michael Lashbrook's affidavit (Appellants' Appendix, p 52a), among other things, explained the workings of the ADA system and the wine wholesaler system. He indicated that the state had three primary ADAs, National Wine & Spirits, General Wine Liquor Company and TransCon (a consortium of three companies) and that the ADAs deliver spirits on behalf of the State of Michigan on a statewide basis, while suppliers have traditionally assigned wine wholesalers to specific limited territories (generally just a few counties). He noted that:

> 17. Many Michigan retail licensees (*e.g.*, retail stores, restaurants, bars) sell (and order) both spirits and wine (and beer). Therefore, ADAs who are delivering spirits on behalf of the State are servicing many of the same retail customers as wine wholesalers who are not ADAs (and who are not delivering spirits).
>
> 18. Since the State is paying (or requiring suppliers to pay) the ADAs' cost of warehousing spirits and delivering spirits to retail licensees, there would be little additional cost to include wine on a truck that is carrying spirits to retailers. Therefore, an ADA who is also licensed as a wholesaler of wine would enjoy an advantage over a licensed wine wholesaler that is not an ADA. Many non-wholesaler ADAs who are members of MB&WWA believe that this advantage enjoyed by ADAs would put non-ADA wholesalers at a severe economic and competitive disadvantage if ADAs/wholesalers were allowed to be "dualed" with non-ADA wholesalers where there was not a dualed situation prior to September 1996.
>
> 23. Among the obvious consequences Section 205(3) sought to avoid was a situation where an ADA would become a wholesaler, be dualed with an existing non-ADA wine wholesaler, and then be able to utilize the State-sponsored ADA funding to gain an unfair advantage over the existing non-ADA wine wholesaler network. In passing Section 205(3), the Legislature obviously recognized that wine wholesalers who are not ADAs had invested money in their business (often over

a long period of time) and had established their businesses within a highly-regulated statutory framework. The State recognized in passing Section 205(3) that it would be unfair to existing wine wholesalers who are not ADAs to put them into competition with ADAs/wholesalers who would have an unfair advantage by assuming functions previously conducted by the State.

24. Section 205(3) recognizes that an ADA/ wholesaler competing with a non-ADA wine wholesaler could have the economic clout to induce wine suppliers to go with the ADA/wholesaler and that this could result in disruption of the wine distribution system to the disadvantage of not only non-ADA wine wholesalers, but also consumers and retailers. In this regard, Section 205(3) recognizes that an ADA/wholesaler who is dualed with a non-ADA wine wholesaler could "cherry-pick" the most lucrative retail outlets (*e.g.*, large retail chains) and leave the smaller, less profitable retail outlets to the non-ADA wine wholesalers. This would be a disadvantage to consumers and to small retailers. And, non-ADA wine wholesalers who might lose large retail accounts in their sales territory, which return a higher per case profit than small accounts, might economically be unable to service the small "mom & pop" retailers and remain in business.

26. Section 205(3) demonstrates that the Legislature was cognizant of the fact that there would be a period of time between the time the statute was amended and its becoming law. Section 205(3) obviously evidences an attempt by the Legislature to avoid a situation in 1996 where ADAs who were wholesalers would have been able to go to suppliers before the law became effective and be "dualed" where they had not been "dualed" previously, and thereby circumvent the purpose behind the statute and destroy or weaken the existing wine distribution system. That is, September 24, 1996, is not an arbitrary date, but rather a date reflective of the legislative process and a date which precluded wholesalers who intended to become ADAs from seeking to circumvent the prohibition against future dualing.

27. To summarize, in the highly-regulated and complex wine distribution system that existed in 1996, Section 205(3) sought to accomplish various goals, including: (i) to protect non-ADA wine wholesalers and the investment they made prior to the passage of the spirits privatization act; (ii) to allow wholesalers who choose to become ADAs to keep the equity they had

> already established in the dual brands prior to privatization of spirits, but prohibit further dualing; (iii) to maintain a strong middle wine distribution tier with a number of different wholesalers; and (iv) to maintain an orderly market in wine by ensuring that retailers, and small retailers in particular, have products delivered to them by wholesalers."

The public records of the Michigan Liquor Control Commission confirm that appellants are not disadvantaged by § 205(3), but rather that NWS Michigan, Inc. (appellants' Michigan ADA) is the dominant ADA in the state, dwarfing the other two primary ADA/wholesalers in the revenue received.[4] In fact, appellant NWS Michigan, receives about 50% of all state revenue paid to ADAs. (MB&WWA Appendix, Records of the Liquor Control Commission, p 80b). State payments to the three largest ADAs (appellant NWS Michigan (NWS) and General Wine & Liquor Company (GWLC) and TransCon) has been as follows the past six fiscal years:

Fiscal Year	TransCon	GWLC	NWS	Percentage of Payments Given to NWS
2004-2005	$7,459,161.40	$13,159,717.32	$20,287,688.51	49.6%
2003-2004	$6,366,110.03	$13,359,461.50	$20,248,474.31	50.7%
2002-2003	$7,029,419.00	$12,246,951.19	$17,991,258.92	48.3%
2001-2002	$7,459,314.30	$10,248,662.98	$17,150,526.00	49.2%
2000-2001	$7,729,945.98	$9,386,834.42	$17,719,299.37	50.8%
1999-2000	$6,317,299.98	$6,701,955.11	$15,710,564.64	54.6%

[4] Public records of the Liquor Control Commission are available under the Freedom of Information Act. The Court can take judicial notice of public records. MRE 201. See also *People v Goecke*, 457 Mich 442, 449 (1998).

These figures from public records refute that appellants have been disadvantaged by § 205.[5]

Appellants submitted two affidavits at the trial level, the affidavits of Steven Null (Appellants' Appendix, p 33a), and Gregory J. Mauloff (Appellants' Appendix, p 122a). At the trial level the appellants also attached a document called "Anderson Economic Group Preliminary Commerce Clause Analysis" dated August 6, 2002.[6] (Appellants' Appendix 104a).

The Trial Court Rulings

The trial court denied appellants' Motion for Summary Disposition on the Equal Protection Clause, stating:

> "I think it's pretty much indisputable that the purpose of preserving an orderly and stable wholesale wine distribution network and yet one which provides for some form of competition is a legitimate state interest given that the regulation of alcoholic beverages is of constitutional magnitude in Michigan, as I think it is in most states.
>
> So we come to the second question, does this classification rationally serve that purpose, or, is this classification arguably rationally related to that purpose. A statute is presumed to be constitutional and the Plaintiffs bear a very heavy burden, and I think in this case they come close. They don't quite make that burden, don't quite shoulder that burden. Until this amendment was enacted in 1996 wine wholesalers in Michigan, and indeed all alcoholic beverage industry businesses in Michigan, lived in a world without ADAs. An ADA is a creature intended

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[5] It should be noted that as large as they are, these payments only represent payments by the state to ADAs and do not include mandated per case payments to ADAs by suppliers. Nor does the summary include other income that may be voluntarily paid by spirits suppliers for marketing activities by ADAs

[6] Appellants tried to rely on their self-serving affidavits filed in the trial court. However, those "affidavits" were objected to in the trial court and should be rejected by this Court since they do not comply with MCR 2.116(G)(6) and MCR 2.119. Appellants now have submitted a new affidavit by Anderson. (See Appellants' Appendix at p 154a).

> in most respects to take the place of direct action by the State of Michigan and its employees. So in a sense the ADA is a surrogate for the State of Michigan.
>
> I think it's also undisputed that for an ADA to also be in the wine wholesaler business is a pretty good economic advantage, particularly when we have competing wholesalers in the same district wholesaling the same brand of wine, so to prevent that very specific and narrow economic disadvantage from being created by privatization, the legislature enacted this amendment, and I think I cannot say that this amendment is not rationally related to that purpose.
>
> Now coming full circle to my original approach to this, which is, is this a legitimate grandfather clause? The sense that I get of legitimate grandfather clause is that they are crated when a regulated business or profession is subjected to greater regulation than it was before and it is felt to be unfair to subject those individuals who have already spent time and money preparing or investing the capital necessary to meet the old requirements, it is unfair to submit to -- require them to submit to these new requirements when as a matter of course over a period of time they will die out. And that's the case here, because these wine wholesalers who were wholesaling a particular brand of wine on a non-exclusive basis in a particular territory before this amendment were doing so, as I say, in a world without ADAs, and once you introduce the ADA into the equation, it becomes a completely different worlds. And yet they made these investments over the years, and they may not all be hard capital, hard goods, they may be relationships, but still they cost money and time and effort to create those ongoing relationship, and I think the legislature can legitimately take the position that it's not fair to strip them of that in this new regulatory climate crated by the introduction of privatization. So, in so many words, I will deny summary disposition to the Plaintiffs". (Appellants' Appendix, p 63a, May 8, 2002, Hearing Tr., pp 19-22).

Subsequently, the trial court granted summary disposition to appellees on the commerce clause challenge, stating, in part:

> "Now, I understand the Plaintiff's argument, that because they were not participating at the cut off date they became forever ineligible to be grandfathered, and that they are an out-of-state firm. I understand that argument, and certainly the statute appears to have that effect, but it has that effect on any entity,

any institution, any company that would have been in the same position as the Plaintiff. It doesn't single out the Plaintiff and it doesn't single out out-of-state companies. That just happens to be the way it was at the time the statute was enacted, and I understand that it may be the Plaintiff's belief that this statute was the result of the mustering of a certain number of legislators in favor of interests that wanted Plaintiff kept out of this sate (sic), I understand that argument, but as I said, that is not the kind of argument that can be the basis of an opinion of a Court. The Court -- the statute is facially neutral. The statute does not in its own terms discriminate in anyway between out-of-state and in-state entities, and the statute is clearly intended to execute the powers that are referred to in the 21st Amendment, and, therefore, on count two Defendant is also entitle to summary disposition. I'll accept an order to that effect. Thank you." (Appellants' Appendix, p 124a, August 14, 2002 Trial Tr., pp 18-20).

The Court of Appeals Decision

In an unpublished Court of Appeals decision dated March 25, 2004, the Court of Appeals affirmed, stating:

"C. Equal Protection

* * *

"Thus, it is well established that preserving an orderly and stable three-tiered alcohol distribution system which also allows some competition is a legitimate government interest. Plaintiffs argue that they are 'unable to imagine a legitimate state purpose for creating these two classes distinguished by the date September 24, 1996.' But the question of whether the date is arbitrary goes to whether the classification is rationally related to defendant's purpose.

"We conclude that the classification based on date is rationally related to defendant's purpose. Before 1996, there were no ADAs because the distribution of alcohol was handled solely by Michigan's Liquor Control Commission. After defendant allowed ADAs to distribute alcohol, it realized that ADAs receiving state subsidies that were also wine wholesalers had an unfair economic advantage over wine wholesalers that were not ADAs. In order to prevent this specific unfair advantage, it decided to preclude ADA/wholesalers from dualing. But

because some ADA/wholesalers already had dualing agreements, defendant did not take away their pre-existing right to dual. It was necessary for the Legislature to insert a date prior to the date the statute was effective because if it had not ADAs and wholesalers would have had a window of time in which to obtain licenses and/or dualing agreements. In other words, it would have allowed circumstances to be altered beyond the status quo.

* * *

D. Commerce Clause

"The reason it allowed already dualing wholesalers to continue to dual after they became ADAs is that they had already entered dualing agreements and defendant did not wish to take this pre-existing right away. 'The fact that the burden of a sate regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce.' *Exxon Corp v Governor of Maryland*, 437 US 117, 126; 98 S Ct 2207; 57 L Ed 91 (1978).

* * *

"Our next determination is whether the statute regulates evenhandedly with only incidental effects on interstate commerce. We conclude that plaintiffs have failed to establish that the statute has even an incidental effect on interstate commerce, i.e., 'the interstate flow of articles of commerce.'

* * *

[W]e discern no indication that the statute prohibits the flow of interstate goods, places an added cost on them or distinguishes between them in the market. The Commerce Clause 'protects the interstate market, not particular interstate firm, from prohibitive or burdensome regulations.' *Exon, supra*, at 217-218." (Appellants' Appendix, p 146a).

This Court heard arguments on appellants' application on July 11, 2006. A copy of the transcript of that hearing is set out as MB&WWA Appendix, p 93b. This appeal follows.

INTRODUCTION

Michigan has complete "control" (monopoly) over the distribution and sale of sprits to retailers. Michigan purchases spirits from suppliers and requires retailers, in turn, to buy from the State at prices set by the State. This ensures State control and generates tremendous revenue for Michigan. Until 1996, Michigan used State employees to warehouse and distribute spirits. In 1996, the Legislature allowed the State to utilize private entities (known as authorized distribution agents [ADAs]) to perform the warehousing and distribution functions previously performed by State employees. ADAs are State agents, through whom spirits suppliers must distribute and from whom spirits retailers must purchase. The State unilaterally sets the compensation for ADAs, the State gives the ADAs access to the retail market, and the State regulates ADAs by statute, administrative rules and administrative orders.

While still a highly regulated distribution system, Michigan does not "control" wine the way it controls spirits. Wine has been, and is, distributed by privately owned licensed in-state wholesalers, who have contracts with suppliers for specific limited sales territories and who market wine products to retailers. The wine distribution is known as a "three tier" system. The tiers consist of suppliers, wholesalers, and retailers. There are numerous prohibitions from one tier having an interest (financial, ownership or leasehold) in another tier, which are an out growth of pre-Prohibition experience.

At issue here is a statute affecting the structure of these two interfacing but distinctly different alcoholic beverage distribution systems. The intervening-defendant appellee Michigan Beer and Wine Wholesalers Association (MB&WWA) represents wine wholesalers. They may not either make wine or sell it at retail. They may only act as

wholesalers. Thus, they are an integral part of the structure of the three tier wine distribution system. In reliance on Michigan's longstanding regulatory framework, they have and must maintain substantial investments in warehouses, trucks and employees.

Unlike ADAs, wine wholesalers do not receive State payments for distribution or warehousing of wine. MB&WWA agrees in part with appellants that the effect of the State payments to ADAs gives them a combined cost economy, in effect a subsidy. MB&WWA disagrees with appellants that the limitations on them, as a recipient of the State subsidies, constitute a commerce clause or equal protection violation.

The central errors of appellants' positions are: (A) assuming that a structural limitation on a subsidized distributor of spirits violates the commerce clause when no product discrimination is present; and (B) assuming that a subsidized distributor of spirits can claim equal protection merely because the legislature or courts will not grant it the economic advantage it wants, to use its subsidy in spirits to take over the State's longstanding and "unquestionably legitimate" wine distribution system.

Summary of Argument

A. Section 205(3) addresses the structure of Michigan's liquor distribution system and does not discriminate against out-of-state products; as a result there is no dormant Commerce Clause violation.

Appellants have missed the central dichotomy. For the dormant Commerce Clause, a distinction is drawn between alcoholic beverage products and structure. Section § 205(3)[7] (by itself or in conjunction with § 601,[8] if relevant) does not violate the dormant Commerce Clause. As recognized by the Court of Appeals, § 205(3) does not

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[7] MCL § 436.1205(3).

[8] MCL § 436.1601.

discriminate against out-of-state goods.[9] Indeed, one will search appellants' brief in vain for any out-of-state goods being denied entry into Michigan.

Rather, § 205(3) reflects structure. It is the exercise of Michigan's Twenty-First Amendment authority, which gives Michigan "virtually complete control* * * [of] how to structure its liquor distribution system".[10]

As long as states do not treat out-of-state products differently than equivalent in-state produced products, state laws dealing with alcoholic beverages and how they are distributed are protected by the Twenty-First Amendment free of dormant commerce clause restraints. Once this Court concludes that there is no product discrimination, the commerce clause illusion proffered by appellants is dispelled.

B. Appellants are treated just like any other Michigan resident.

Even if § 205(3) was not the exercise of a Twenty-First Amendment authority, there would be no dormant Commerce Clause issue here. Section 205(3) does not discriminate against out-of-state entities as recognized by both lower courts. And, even assuming incorrectly that there was some disparate treatment, it would not give rise to a commerce clause violation because the commerce clause "protects the interstate market, not

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[9] Appellants do not challenge this conclusion.

[10] *California Retail Liquor Dealers Assn v Mid-Cal Aluminum, Inc*, 445 US 97, 100, 63 L Ed2d 233, 100 S Ct 937 (1980). This was reaffirmed most recently by the U.S. Supreme Court in *Granholm v Heald*, 544 US 460, 125 S Ct 1885, 1905; 161 L Ed2d 796 (2005): "State policies are protected under the Twenty-First Amendment when they treat liquor produced out of state the same as its domestic equivalents." As part of the permitted structure of distribution, states can require that liquor "'sold for use in the State be purchased from a licensed in-state wholesaler.'" *Id*, quoting *North Dakota v United States*, 495 US at 447 (Scalia, J., concurring in judgment).

particular interstate firms, from prohibitive or burdensome regulations". *Exxon Corp v Governor of Maryland*, 437 U.S. 117, 127-128 (1978).

Appellants (through NWS Michigan, Inc.,) have been allowed to become an authorized distribution agent (ADA) for spirits. While separate entities, appellants present themselves as if they were a single Indiana migrant, bereft of quarter here. In fact, NWS Michigan has concentrated its efforts as an agent of the state in warehousing and delivering spirits as its initial business in Michigan from 1996 to 1999. It is, and has been, the highest paid ADA in the State, receiving over $20 Million from the State in fiscal year 2004 alone.[11] That is some $7 Million more than the next closest ADA, with roots in Michigan. As a newcomer, appellants have exaggerated their plight as a would-be victim of discrimination. NWS Michigan, Inc., receives approximately 50% of all revenue paid by the State to ADAs for spirits distribution. How does this evidence discrimination by Michigan? Are not appellants really asking this Court to grant them a monopoly?

After devoting several years to establishing their economic clout as the leading distributor of spirits in Michigan, appellants (through National Wine & Spirits, L.L.C.) decided to enter the wine business. Were appellants prohibited from doing so? No. National Wine & Spirits, L.L.C., became a licensed wine wholesaler in 1999. Had it been in existence, National Wine & Spirits, L.L.C., could have become a wine wholesaler in 1940, 1980, 1990, or at any other point in time after Prohibition. National Wine & Spirits, L.L.C., has exactly the same rights (and limitations) as any other Michigan wine wholesaler.

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[11] See MB&WWA Appendix, p 80b, which sets out the history of State payments to ADAs from 1999 to the most recent fiscal year. The summary does not include State mandated per case payments from suppliers to ADAs.

If appellants did not want to also act as an ADA (and receive millions of dollars in State revenue), National Wine & Spirits, L.L.C., could seek to be dualed for any particular wine product anywhere in the State, just like any other wholesaler who is not an ADA. However, since appellants want to be both an ADA (with its lucrative remuneration by the State that they admit gives them a combined cost economy) and a wine wholesaler, appellants are subject to the same dualing limitations that would affect any other wine wholesaler (or other Michigan resident) who chooses to become both an ADA and a wholesaler.

C. The "dualing" limitations of § 205(3) apply to everyone and do not keep goods or appellants out of the Michigan market.

Certainly § 205(3) imposes certain "dualing" limitations on anyone who wants to be both an ADA and a wine wholesaler. Those limitations do not keep foreign products out of Michigan. Nor do they interfere with the flow of goods that cross state lines into Michigan. Rather, those dualing limitations were imposed by the Legislature as a way of accommodating the *State's* interest in utilizing private entities (ADAs) who would be paid by the State to distribute State "controlled" spirits to in-state retailers. In 1996, the State chose to utilize private "agents" (ADAs) rather than State employees to warehouse and deliver spirits. It also chose to structure this system in such a way that it would not disrupt the parallel but structurally distinct three tier distribution system for wine (which has been in effect since the repeal of Prohibition).[12]

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[12] That three tier distribution system has been recognized as an "unquestionably legitimate" exercise of the State's Twenty-First Amendment authority. *Granholm v Heald, supra*, and *North Dakota v United States,supra*.

When Michigan decided to stop distributing spirits itself, the State had to insure that it had adequate entities available who were familiar with alcoholic beverage distribution. The distributors had to have a working knowledge of the Liquor Control Code and the infrastructure to warehouse and distribute spirits. They had to be capable of undertaking what had heretofore been a State function performed by State employees. To accomplish its semi-"privatization" goals the Legislature chose to allow wine wholesalers to also be ADAs.

At the same time, the State recognized that ADAs with their State guaranteed payments, State controlled distribution market to all in-state retailers, and statewide distribution territories could disrupt the structure of the wine distribution system, which historically has insured that wine suppliers and wine retailers have access to numerous wholesalers rather than only a few ADA/wholesalers. In balancing its need for ADAs with the long established policy of a three tier distribution system for wines, the Legislature placed certain "dualing" restrictions on wine wholesalers who voluntarily chose to become ADAs. These limitations were not aimed at out-of-state companies. NWS Michigan, is a prime example, being the most successful ADA. Rather, the limitations were directed at existing wholesalers.

D. Section 601 with its one year residency requirement is not at issue in this case, nor is it relevant.

Appellants did not challenge the one year residency requirement when National Wine & Spirits, L.L.C., became a wine wholesaler in 1999. Appellants did not challenge the constitutionality of § 601 in the trial court. Appellants even admitted at oral argument

before this Court that § 601 is "not the focus of our challenge here."[13] Inconsistently, they now attempt to insert that statute at this late stage of the process. Appellants' argument is that they couldn't have qualified as a wholesaler on day one of ADA licensing, and so this Court should transmogrify appellants' entry into the wine business some three years later into a commerce clause or equal protection violation.

Section 601 is not rightly at issue here since it was not challenged when NWS Michigan became an ADA and it was not challenged below. But, even assuming it were somehow relevant, surely it did not prevent National Wine & Spirits, L.L.C., from becoming a wholesaler prior to September 24, 1996.

Section 601 does not impose any dualing limitations on appellants. If National Wine & Spirits, L.L.C., as a wine wholesaler wants to be free of all dualing restrictions, it can do so simply by ceasing to be an ADA. It will then be treated just the same as any other wine wholesaler who is not an ADA.

Finally, even if the residency requirement of § 601 were at issue, the U.S. Supreme Court has twice recently confirmed that under the Twenty-First Amendment, states can require their wholesalers to be State residents.[14]

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[13] Transcript of January 11, 2006 hearing on Application for Leave to Appeal, MB&WWA Appendix, p 97b. Counsel for appellants also stated "we have not challenged it [§ 601] nor do we think it is critical to our case." *Id* at 99b.

[14] See *Granholm v Heald*, 544 US 460; 125 S Ct at 1905, where the Court stated:

> "We have previously recognized that the three tier system itself is 'unquestionably legitimate'. *North Dakota v United States,* 495 U.S., at 432, 110 S. Ct. 1986. See also *id*, at 447, 110 S. Ct. 1986 (Scalia, J., concurring in judgment) ('The Twenty-first Amendment. . .empowers North Dakota to require that **all liquor sold for use in the State be purchased from a licensed in-state wholesaler**'). State policies are protected

E. **This case involves economic legislation which is rationally related to preserving the "unquestionably legitimate" three tier distribution system for wines and, therefore, is immune from an equal protection clause challenge.**

Appellants' equal protection challenge to this economic legislation must fail since appellants have not met their heavy burden of showing that the legislation is irrational. Since the repeal of Prohibition, the Legislature has put in place and maintained a three tier distribution system for wine. In § 305(1) of the Liquor Control Code[15], the Legislature declared it Michigan's public policy to "maintain a sound, stable and viable three-tier distribution system of wine to the public". The legislative restrictions on ADAs/wholesalers do not prohibit anyone from becoming a wine wholesaler, from purchasing an existing wholesaler, or from wholesaling many new brands of wine.

Section 205(3) puts restrictions on ADAs who are also wholesalers in order to maintain an orderly market for wine and to insure that there are numerous wine wholesalers (rather than a few large ADA/wholesalers dominating the market with their State payments and access to all spirits retailers). This assures adequate wholesalers in the market to service wine suppliers and retailers (including small "mom and pop" retailers) and bolsters competition. As recognized by both lower courts, the September 24, 1996, date was important, being inserted into the statute in order to avoid potential ADA/wholesalers subverting the goal of the statute by obtaining "dualing" appointments in late 1996, before the statute's effective date, thereby altering the *status quo* and

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> under the Twenty-first Amendment when they treat liquor produced out of state the same as its domestic equivalent." (Emphasis added).

[15] MCL 436.1305(1).

disrupting the structure of the distribution system. Section 205(3) rationally deals with a complex issue in a complex, highly regulated industry involving the only product addressed in the United States and Michigan Constitutions.

ARGUMENT

I. SECTION 205(3) DOES NOT VIOLATE THE DORMANT COMMERCE CLAUSE BECAUSE IT REPRESENTS THE EXERCISE OF MICHIGAN'S AUTHORITY TO STRUCTURE ITS DISTRIBUTION SYSTEM FOR INTOXICATING LIQUORS UNDER THE TWENTY-FIRST AMENDMENT AND BECAUSE EVEN IF THE TWENTY-FIRST AMENDMENT DID NOT EXIST, THERE IS NO DISCRIMINATION AGAINST OUT-OF-STATE PRODUCTS OR ENTITIES AND THE STATUTE DOES NOT IMPERMISSIVELY BURDEN THE FLOW OF INTERSTATE GOODS.

A. The dormant commerce clause prohibits discrimination against out-of-state alcoholic beverage products, not the structure of the State's distribution system that treats out-of-state products the same as equivalent in-state produced products.

The two cases that most strongly show the error of Appellants are *Granholm* and *Exxon.* The U.S. Supreme Court's recent decision in *Granholm v Heald* reaffirmed that states have "virtually complete control" over how to structure the alcoholic beverage distribution system free of dormant commerce clause constraints, as long a a state treats products produced out-of-state the same as equivalent products produced in the state. As summarized by *Granholm*:

> "'The Twenty-first Amendment grants states virtually complete control over. . .how to structure the liquor distribution system.' * * * State policies are protected under the Twenty-first Amendment when they treat liquor produced out of state the same as its domestic equivalent."
> *Granholm*, 125 S Ct at 1905.

Here, no out-of-state products are being treated differently. There is just a disagreement as to how to structure the distribution system. But as *Granholm* reiterates, such state policy choices "are protected under the Twenty-first Amendment."

While the residency requirement of § 601 is not rightly at issue here (for numerous reasons) *Granholm* also rules out any claim that Michigan cannot require wholesalers to

be residents. In this regard, *Granholm* reaffirmed *North Dakota v United States*,*supra*, and adopted as the rule of the majority in *Granholm*, Justice Scalia's concurring opinion in *North Dakota* that: "The Twenty-first Amendment. . .empowers North Dakota to require that all liquor sold for use in the State be purchased from a licensed *in-state* wholesaler". *Granholm*, citing *North Dakota*, 495 US at 447[16]. (Emphasis added). Anyone subscribing to truth in reading, or text based interpretations, would know that "in-state" means a resident. Since the State can require liquor wholesalers to be in-state residents, appellants' commerce clause construct, based on residency discrimination, is a house of cards with no foundation.

Even before *Granholm,* the Supreme Court in *Exxon* had ruled out merit to appellants' Commerce Clause challenge. There, even without the Twenty-First Amendment authority to structure its wholesaling liquor distribution system, the Court upheld an economic structure for petroleum distribution, as correctly recognized by the Court of Appeals.

B. Section 205(3) is facially neutral.

Appellants baldly assert (without any factual support) that§ 205(3) had as its goal to unfairly discriminate against out-of-state businesses. That argument is feckless. As the lower courts found, the challenged legislation is neutral on its face and in application. It treats all entities alike. Section 205(3) allows any out-of-state entity to immediately become

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[16] Obviously, extradition is no substitute for search and seizure.

an ADA and actually limited distribution rights for any existing wine wholesaler (from Michigan) who was going to become an ADA.[17]

Although they never challenged it in the trial court, appellants now make much of § 601 of the Code, which requires one year residency prior to obtaining a wholesaler license.[18] But, where is the injury? Appellants do not claim that § 601 would have precluded National Wine & Spirits, L.L.C., from becoming a wholesaler prior to September 24, 1996, just as it did not preclude National Wine & Spirits, L.L.C., from becoming a wholesaler after September 24, 1996. In fact, National Wine & Spirits, Inc., had the ability to become a wine wholesaler in 1950, 1970, 1985, or any other time prior to September 24, 1996.

This suit is *not* about the constitutionality of § 601 which was not challenged in the trial court, as appellants admit, and so it is not a preserved issue.[19] Indeed, at oral argument on the application appellants admitted that § 601 "is not the focus of our challenge here"

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[17] Before § 205(3) all wholesalers had the right to be appointed (with the supplier's permission) as a "dual" (*i.e.*, two wholesalers appointed to distribute the same brand in the same territory). Under Section 205(3), the right of ADAs/wholesalers to be "dualed" is limited to brands and territories where a wholesaler has already established equity and built a brand prior to September 24, 1996, or where the ADA/wholesaler acquires distribution rights by acquisition, purchase or merger.

[18] Section 601 has been part of Michigan's regulated scheme since the repeal of Prohibition and its obvious goal is to ensure that Michigan has effective jurisdiction over anyone licensed as a wholesaler. For example, since the State audits wholesalers' records to assist with verifying the tax payments of out-of-state suppliers (by cross checking wholesaler sales records against tax payments by out-of-state suppliers) there are legitimate reasons why Michigan would want a wholesaler to be a state resident.

[19] *See Swickard v Wayne County Medical Examiner,* 438 Mich 536, 558, n 16 (1991) (issues not presented to trial court are not preserved for appeal) and *Village of St. Clair Shores v Village of Grosse Pointe*, 319 Mich 372, 375 (1947) (an issue not submitted to or passed upon by the trial court cannot be considered on appeal).

and "as you point out, your Honor, we have not challenged it [§ 601] nor do we think it is critical to our case." "We are operating now". "We have met the residency requirement".[20]

The lack of discriminatory intent in § 205 can be seen in the fact appellants were allowed to immediately act as an ADA upon passage of the privatization legislation and are now the largest ADA in the State.[21] This Court (like the trial court and Court of Appeals) should see appellants' unsupported allegations regarding legislative intent for what they are: pure speculation unsupported by anything in the statute or the facts presented to the trial court. This Court disfavors "augury".[22] Rather, admissible evidence is required. *See generally, Maiden v Rozwood*, 461 Mich 109 (1999) and MCR 2.116(G)(6). There simply is no admissible evidence of an intent to discriminate against out-of-state entities in the record.

C. The legislation is not protectionist.

Appellants' do not distinguish between the reliance interest of existing businesses and protectionist legislation. The distinction lies in the effect, going forward, of new legislation. Where, as here, an out-of-state entity may qualify to do business on an equal footing going forward, there is no protectionism present. The problem Appellants present is that as a newcomer to Michigan, they want to not only get all the advantage of being a

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[20] Transcript of January 11, 2006 hearing on Application for Leave to Appeal, pp 5 and 7, MB&WWA Appendix, p ___.

[21] Although there is no residency requirement for an ADA (apparently because ADAs are the "agents" of the State and operate under the State's rules and orders), NWS Michigan is a Michigan corporation.

[22] "[H]ow can we, absent some form of augury, possibly declare this unknown form of discharge was not sudden and accidental." *Polkow v Citizens Ins Co*, 438 Mich 174, 179; 476 NW2d 382 (1991), reh den, 439 Mich 262.

subsidized ADA, but also become a "free rider" to then use that subsidy and have the Court deliver on a silver platter existing wine distribution. Examined closely, appellants' economic argument is self-defeating.

Appellants premise is that ADA-wholesalers get a subsidy in the form of a combined cost economy. Then they say that if they cannot use that subsidy to take over the rest of the wine distribution tier, they have been the victim of protectionism because they are a poor migrant, beleaguered by the inability to capture wine markets of Michigan wholesalers. The flaws in this are legion.

First, so-called "grandfather clauses" may rightly recognize the reliance interest in existing businesses. *See City of New Orleans v Dukes,* 427 US 297, 305; 96 S Ct 2513; 49 L Ed2d 511 (1976): "The city could reasonably decide that newer businesses were less likely to have built up substantial reliance interests in continued operation in the Vieux Carre and that the two vendors who qualified under the 'grandfather clause' both of whom had operated in the area for over 20 years rather than only eight had themselves become part of the distinctive character ... ." *City of New* Orleans, 427 US at 305. See *also Peoples Rights Organization, Inc v City of Columbus,* 152 F3d 522, 531 (6th Cir, 1998), citing *New Orleans v Dukes* for the point, "The Supreme Court has approved the legitimacy of reliance interests." Indeed, "The protection of reasonable reliance interests is not only a legitimate governmental objective: it provides 'an exceedingly persuasive justification' for the statute...." *Heckler v Mathews,* 465 US 728, 746; 104 S Ct 1387; 79 L Ed2d 646 (1984) (quoting *Kirchberg v Feenstra*, 450 US 455, 461 (1981).

Second, if the reliance interest were not recognized, then parties such as appellants that want to not only corner the spirits market but then take over wine would be given the

"free rider" effect to do so on a silver platter. In other contexts the free rider effect has been recognized. "Because another distributor might incur the expenses to promote the product and provide customer service, 'free riders' are able to successfully sell the product, at a lesser cost, by enjoying the benefit of increased demand created by the efforts of others." *Bascom Food Products Corp v Reese Finer Foods, Inc,* 715 F Supp 616, 622, n 11 (D NJ, 1989). Here that lesser cost of distribution is compounded by the subsidy that is the premise of appellants' economic argument. See also *H L Hayden Co v Siemens Medical Systems, Inc,* 672 F Supp 724, 751 (SD NY, 1987): "a '[f]ree rider is a firm who takes advantage of a service or product that is valued by customers but provided by a different firm.'" In *Bascom,* the Court noted, "The free-rider problem was invoked as a justification for certain territorial restrictions in the landmark decision of *Continental TV, Inc v GTE Sylvania, Inc,* 433 US 36, 55; 97 S Ct 2549, 2560; 53 L Ed2d 568 (1977), a case involving restraints in the context of vertical distribution arrangements." *Bascom,* 715 F Supp at 622.

Thus, when appellants come to court under the guise of being the "victim" of combined cost economies, really a State subsidy on distribution costs, yet are the biggest recipient of the ADA subsidies, their true role as wolves in sheep's clothing is revealed. Appellants are not the victim of commerce clause or equal protection discrimination. Appellants exploited the very protection in the Act they now attack to establish their ADA business.[23] Now that appellants are the State's largest ADA, they want to get into wine as

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[23] In the Application, appellants said that they were disadvantaged in 70% of the wine market serviced by other ADA-wholesalers because they had combined cost economies. But that means that in the remaining 30% of the wine market appellants had the protection inherent in the Act of entering the State and establishing their spirits business without competing with any ADAs with combined cost economies. Had the statute not restricted Michigan based ADAs, appellants' economic theory would mean that they could not have feasibly entered the State since all wine and spirits would have been locked up

a "free rider". Now that appellants have established NWS Michigan as the largest recipient of ADA payments from the State, they want to lull this court into granting a writ of assistance to use their ADA subsidies to victimize existing wholesalers who have a rightful reliance interest in the markets they established. In terms of the three tier system, the effect of the subsidized dualing appellants want would be to gut the middle tier of wine distribution, and combine all wine and spirits distribution in a limited number of distributors vertically integrated near the manufacturer tier for both.

Third, as voluntary governmental agents appellants should not have the right to complain about structural restrictions. Appellants, through NWS Michigan, are an authorized distributor agent of the State of Michigan. Appellants voluntarily accepted that role. They do not have the same standing as a non-governmental agent. By the same token, they are subject to economic, social and political considerations implicit in accepting the benefits of being an agent of the State with its regulated monopoly on distribution of spirits, for which it has subsidized distribution of products. Governmental agencies are always subject to economic, social and and political considerations determined to be of overriding interest, even in the antitrust arena. *Cf Northern Natural Gas Co v Federal Power Commission*, 399 F2d 953, 961 (DC Cir 1968).

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by pre-existing wholesalers with combined cost economies. Appellants success in not only entering Michigan for the first time in 1996, and now capturing 50% of all ADA payments from the State, flatly belies the discrimination claim. However, the economic theory on which it relies here, combined cost economies, logically means that it would take over the rest of wine distribution if freed from anti-dualing limitations appellants used to establish their ADA business from 1996 to 1999. If granted the relief requested, appellants could then exercise combined cost economies to attack remaining ADA-wholesalers since it now has a full third more ADA payments than the closest ADA, which it would have to admit would let it have more combined cost economy advantage than any other Michigan ADA-wholesaler. Obviously, appellants true goal is a monopoly or near monopoly over spirits and wine distribution.

Fourth, parties being given governmental subsidies do not stand on the same footing when then claiming constitutional violations such as equal protection in trying to gain additional benefits in other contexts. In other words, parties such as NWS Michigan (and its affiliate companies) who are benefitting from governmental subsidies cannot claim that they are discriminated against because in other contexts they do not get additional cake to eat, too. For example, in *Nunemaker v SEC HEW,* 679 F2d 328, 335 (3rd Cir, 1982), a recipient of a federal rental subsidy claimed that it violated equal protection to then reduce supplemental security income benefits based on an income-in-kind attribution. The Court disagreed noting that Congress did not have to give additional benefits to those receiving the subsidies. Surely the Michigan legislature does not have to grant all the advantages of a wine wholesaler not receiving an ADA subsidy, to those receiving an ADA subsidy.

Similarly, in *Jenkins v Chatham Properties, LTD,* 496 F Supp 250, 252 (SD GA 1980), a group of welfare recipients who received a utility allowance exceeding their tenant rent brought suit challenging the practice of an owner of federally subsidized housing to refuse to rent to such tenants, pursuant to regulations. On a motion for a preliminary injunction the Court found a lacking of a substantial likelihood of success on the equal protection and due process challenge. Corporate subsidy recipients like appellants should have no more success than other recipients of governmental benefits. Likewise illustrative of the point that governmental subsidy recipients do not stand on the same footing in other contexts, is *Ruhe v Block,* 507 F Supp 1290 (ED VA 1981). There a group of food stamp recipients challenged the inclusion of cash housing subsidies in their "income" for the purpose of computing their food stamps. For one of the illustrative plaintiffs, by including the rent subsidy of $80.89 in her income for computing her food stamp allotment, she

received a food stamp allotment of $35.00; however, "If the housing subsidy were not included in her income, she would receive at least $13.00 to $15.00 more per month in food stamps." *Id* at 1293. The Court, while "sympathetic to the plight of the recipients of the Arlington County funds and recognizes that the distinction as to who actually receives the money is an artificial one and one which works, unfortunately, to these plaintiffs' detriment", still rejected the equal protection challenges. *Id* at 1298. Even when it was acknowledged that some welfare recipients in other states had housing subsidies paid directly to the tenants whereas in others the subsidies were paid to the landlord and so the food stamp calculation was different, the Court still denied them the additional food stamp benefits of $13.00 to $15.00 per month.

This Court may be appropriately sympathetic to the plight of the NWS conglomerate, which, at $20.0 million of State ADA payments, receives merely $7.0 Million more than the next lower recipient of ADA payments and thus does not get all the combined cost economies it wishes to bring to bear on wholesalers getting *none*, yet still not hold that appellants have been deprived in a constitutional sense in light of cases such as *Nunemaker*, *Jenkins,* and *Ruhe*. Like the food stamp and rent subsidy recipients in the above cases, it is not correct for appellants to assume that because they are a successful recipient of one governmental subsidy, that the constitution requires that they be given every other possible benefit imaginable even if posing as a migrant.

Moreover, appellants' brief misconstrues the defendant's commerce clause argument when they state that defendants have "admitted" that the purpose of Section 205(3) was enacted to favor in-state wholesalers over out-of-state entities. If that were the purpose, the statute could have been drafted in such a way as to preclude appellants from being an

ADA – but, of course, that was not done. And appellants even boast that the State turned to them for advice. *See* MB&WWA Appendix, p 3b, Complaint, ¶ 25. The only interest sought to be protected in Section 205(3) was the *State's interest* in an ADA structure that left intact a *viable* three-tier distribution system for wine. But, even if Michigan had protected the reliance interest of existing wholesalers, that would have been a rightful consideration, as briefed *supra.*

The State of Michigan (through the Legislature) obviously determined that it would promote the *State's interest* to have a wine wholesaler tier that was partly but not all ADAs. It also did not want the middle tier of wine to be all ADAs with State subsidized spirits distribution. It did not want State subsidized ADA's to unfairly compete against non-ADA wine wholesalers. Such a scenario would disadvantage small retailers and consumers because the new ADAs would have a free ride to use the subsidized spirits distribution to usurp the markets developed by wholesalers. They could cherry pick large accounts to the detriment of servicing all outlets. Finally, it cannot be overstressed that the Legislature did not want to either combine all wine and spirits or vertically integrate all wine distribution near the manufacturer level. All these considerations support the State's "unquestionably legitimate" existing three-tier distribution system for wine. *See* Appellants' Appendix, p 52a, Lashbrook Affidavit.

D. Michigan may structure distribution pursuant to the Twenty-First Amendment.

Appellants mischaracterize the Twenty-First Amendment and cases which address the Twenty-First Amendment. Appellants completely ignore the plain language of the Twenty-First Amendment and the long, unbroken line of Supreme Court authority that holds

that the dormant commerce clause does not "trump" the Twenty-First Amendment where a state structures its alcoholic beverage system in such a way that it does not discriminate against out-of-state products. *See, e.g., Capitol Cities Cable, Inc v Crist*, 467 US 691, 712, 715 (1984) (where the Supreme Court noted that exercising state control over "how to structure the liquor distribution system is the central power reserved by Section 2 of the Twenty-first Amendment"); *California Retail Liquor Dealers Ass'n v Mid-Cal Aluminum, Inc*, 445 US 97, 107-108 (1980) ("[E]arly decisions on the Twenty-first Amendment recognized that each State holds great powers over the importation of liquors from other jurisdictions . . .." and "The Twenty-first Amendment grants the States virtually complete control over whether to permit importation or sale of liquor and *how to structure the liquor distribution system.*") (emphasis added); *Hostetter v Idlewild Bon Voyage Liquor Corp*, 377 US 324, 330, 333 (1936) (recognizing a state's right to regulate or control the transportation of liquor from the time of its entry into the State in order to avoid unlawful diversion into its territory).[24]

The two most recent Supreme Court decisions to address a state's right to structure its alcoholic beverage system are *North Dakota v United States*, 495 US 423, 431-433 (1990), and *Granholm v Heald, supra*. In *North Dakota*, the Supreme Court recognized state authority on structure. It held that within "the area of its jurisdiction, the State has

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[24] As a review of the case law will indicate, there are factual situations completely different than those at issue here where a state acting outside of its Twenty-first Amendment authority may violate another provision of the constitution. However, even these cases recognize the limitation put on the dormant commerce clause when a sate is involved with the delivery of alcohol within its borders. *See, e.g., 44 Liquormart, Inc v Rhode Island*, 517 US 484, 516 (1996) ("[T]he Twenty-first Amendment limits the effect of the dormant Commerce Clause on a State's regulatory power over the delivery or use of intoxicating beverages within its borders . . ..").

'virtually complete control' of the importation and sale of liquor and the structure of the liquor distribution system." In upholding a North Dakota statute that was challenged as violating the Supremacy Clause, Justice Stevens, for a four-Justice plurality, stated:

> "The two North Dakota regulations fall within the core of the State's power under the Twenty-first Amendment. In the interest of promoting temperance, ensuring orderly market conditions, and raising revenue, the State has established a comprehensive system for the distribution of liquor within its borders. That system is unquestionably legitimate" *Id.* at 431-432.

Justice Scalia, concurring, stated:

> "The Twenty-first Amendment . . . empowers North Dakota to require that all liquor sold for use in the State be purchased from licensed in-state wholesalers." 495 U.S. at 447.[25]

The Twenty-First Amendment controls over the Commerce Clause when a state merely structures its alcoholic beverage system.

The dichotomy between structure and products was drawn in the most recent U.S. Supreme Court case dealing with the interplay between the dormant commerce clause and the Twenty-First Amendment, *Granholm v Heald, supra.*[26] While finding a dormant commerce clause violation because of *product* discrimination, the *Granholm* court

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[25] Four Justices dissented in *North Dakota* on a federal immunity issue, but no Justice disputed that a state could require that imports of alcoholic beverages for state residents go through a licensed wholesaler. *See North Dakota, supra,* 495 U.S. at 448-471. Regardless, the concurring opinion of Justice Scalia was adopted by the majority in *Granholm* so structure is unquestionably legitimate.

[26] *Granholm v Heald*, is factually distinguishable from the instant case as *Granholm* involves a statute that gave preferential treatment to in-state wine products by allowing them to be directly shipped to Michigan residents while not allowing out-of-state wine producers to directly ship their products. The Michigan Legislature has now corrected that problem by allowing in-state and out-of-state wine producers to directly ship if they are properly licensed by the state and comply with all state rules.

reconfirmed that state laws are protected from dormant clause challenges where they treat in-state and out-of-state products the same:

> "The States argue that any decision invalidating their direct-shipment laws would call into question the constitutionality of the three-tier system. This does not follow from our holding. The Twenty-first Amendment grants the states virtually complete control over whether to permit importation or sale of liquor **and how to structure the liquor distribution system**. * * * States may also assume direct control of liquor distribution through state-run outlets or funnel sales through the three-tier system. We have previously recognized that the three-tier system itself is 'unquestionably legitimate'. *North Dakota v United States*, 495 U.S., at 432, 109 L. Ed. 2d 420, 110 S. Ct. 1986. See also *id*, at 447, 109 L. Ed. 2d 420, 110 S. Ct. 1986 (Scalia, J., concurring in judgment. ('The Twenty-first Amendment . . .empowers North Dakota to require that all liquor sold for use in the State be purchased from a licensed in-state wholesaler'). State policies are protected under the Twenty-first Amendment when they treat liquor produced out of state the same as its domestic equivalent." *Granholm*, 544 US at 460; 125 S Ct at 1904-1905. (Emphasis added).

E. Appellant's cases are off point.

Appellants are asking this Court to intrude into the State's control and structure of its alcoholic beverage distribution. In fact, such a holding would be inconsistent with *Granholm v Heald, North Dakota* and the long line of Supreme Court authority that begins immediately after the repeal of Prohibition and continues to this date.

In support of its arguments appellants primarily rely upon four off point or mis-cited cases: *Hostetter, supra*, 377 US 324; *California Retail Liquor Dealers Ass'n, supra*, 445 US 97; and *Bacchus Imports Ltd v Dais*, 468 US 263 (1984); and *Granholm v Heald, supra*. However, those cases are distinguishable or support the State.

Hostetter addressed an entirely different issue, *i.e.*, whether the State of New York had the right to prohibit passage of liquor (under the supervision of the U.S. Bureau of Customs acting under federal law) through New York for delivery to consumers in foreign countries. That is a product restriction case, not our facts that bear on structure. Indeed, *Hostetter* cited with approval the numerous Supreme Court cases dealing with a state's plenary authority under the Twenty-First Amendment to regulate the structure of its alcoholic beverage distribution system free of Commerce Clause restraints. *Hostetter,* 373 US at 330-331.

Bacchus Imports, supra involved an Hawaii statute which exempted locally produced pineapple wine product from Hawaii's excise tax. Hawaii acknowledged that this was a protectionistic statute aimed at discriminating against out-of-state products. Here, in contrast, one will search our record in vain for a similar product restraint. Certainly, *Bacchus Imports* did not involve the state's right to structure its distribution system as does the instant case.

The fact situation in *California Retail Liquor Dealers Ass'n v Mid-Cal, supra* also does not resemble the instant case. *California Retail Liquor* dealt with a state's right to allow private entities to establish price schedules. This resulted in illegal retail price maintenance by private entities throughout the state affecting products, not the structure of distribution. Again, those are not our facts. Still, *California Retail Liquor* recognized structure as an area where the Twenty-First Amendment insulates states from the operation of the Commerce Clause. *California Retail Liquor*, 445 US at 110: "The Twenty-First Amendment grants states virtually complete control . . . [in] how to structure the liquor distribution system.".

Finally, appellants reliance on *Granholm v Heald* is mere wishful thinking. Its actual holding is that while Michigan may not discriminate against wine products from other states, it may determine its structure for distribution, and may indeed require residency.

F. Even if the dormant commerce clause were at issue, an incidental effect on appellants' business does not result in a commerce clause violation.

Even setting aside the Twenty-First Amendment, and even assuming incorrectly that there is some unique impact or burden on appellants in the application of § 205(3), there still would not be a dormant commerce clause violation. There is no dormant commerce clause violation where out-of-state entities have access to the State market even if there is some incidental burden to a party in appellants' position. *See Exxon Corp v Governor of Maryland*, 437 US 117, 128-129 (1978). *Exxon* involved a Maryland statute that required out-of-state oil/gas refiners to divest themselves of Maryland gas stations and which prohibited them from operating gas stations in Maryland. Only out-of-state refiners were affected as there were no in-state refineries. The *Exxon* court found no commerce clause problem because the statute does not prohibit the flow of interstate goods, place added costs on them or distinguish between in-state or out-of-state companies, even though only out-of-state companies were required to divest their in-state retail outlets.

Appellants reliance (see Brief, pp 3 and 4, 20 and 27) on *C&A Carbone, Inc v Town of Clarkston, NY*, 511 US 383, 114 S Ct 1677, 128 L Ed 2d 399 (1994), for the proposition that § 205(3) violates the commerce clause is without merit.

C&A Carbone is factually and legally distinguishable. In *Carbone*, one local company was given the sole right to process all waste for a municipality and all other waste processors (whether in-state or out-of-state) were prohibited from handling waste for a five

year period. Here, in contrast, no company, whether in-state or out-of-state, is prohibited from being an ADA or a wholesaler (as evidenced by the fact that appellants are both).

However, there is also an even more striking distinction. *C&A Carbone* did not involve alcoholic beverages and the Twenty-First Amendment. As noted, *infra*, as long as out-of-state products and their in-state produced equivalents are treated the same, the Twenty-First Amendment allows states to require that all alcoholic beverages pass through the State or its licensed three tier distribution system -- a system the U.S. Supreme Court has repeatedly held "unquestionably legitimate". *Granholm v Health*, 125 S Ct at 1905, and *North Dakota v United States*, 495 US at 431-432 and 447.[27] Here, appellants have never challenged Michigan's right to require all spirits to pass through the State (and ADAs) or all wines to pass through the three tier wine distribution system. Indeed, appellants are actors in both those distribution systems and concede that such systems are legitimate. (Appellants' Brief, pp 6, 7).

G. Congress has delegated any residual commerce clause power affecting structure of alcoholic beverage distribution to states.

If there was any question as to the structure of alcoholic beverage distribution being governed by an overlap of the Commerce Clause and the 21st Amendment, that question has been answered legislatively. Federal statutes also reserve to Michigan the right to structure its alcohol distribution system. Congress has acquiesced to the state's exercise of that power by enacting the Webb-Kenyon Act (27 USC § 122), which divests intoxicating liquors of their interstate character.

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[27] Similarly, the cases cited on page 33 of appellants' brief regarding truck size are all factually and legally distinguishable.

As the trial court and the Court of Appeals recognized, there is no commerce clause issue here because there is no discrimination or burden on interstate commerce. Even assuming incorrectly that there was a commerce clause issue and the Twenty-First Amendment did not allow states to structure the alcohol distribution systems, any residual commerce clause power is to be exercised by Congress. It adopted the Webb-Kenyon Act that gives Michigan the right to structure its alcohol distribution system.

II. THE TRIAL COURT AND THE COURT OF APPEALS CORRECTLY FOUND THAT § 205(3) IS RATIONALLY RELATED TO A LEGITIMATE STATE PURPOSE SO THERE IS NO EQUAL PROTECTION VIOLATION.

The notion that appellants are a victim of an equal protection violation when NWS Michigan is the largest recipient of ADA payments that it admits gives one a combined cost economy advantage (in reality a state subsidy on distribution) is hardly meritorious. A party who is the recipient of a governmental subsidy cannot claim that it must be given all other governmental benefits as if it had not gained the advantage of its first benefit, as illustrated in *Nunemaker*, *Jenkins,* and *Ruhe*, *supra.* Nor does the insertion of a grandfather clause change this result where, as here, all are treated the same going forward. A detailed analysis of the standards for equal protection claims bears this out in the instant context as well. Where there is any conceivable, rational basis for economic legislation, there is no equal protection violation.

A. Economic legislation test.

Equal Protection clauses of the United States Constitution and the Michigan Constitution are co-extensive. US Const, Am XIV; Mich Const 1963, art 1, § 2. *Wysocki v Felt*, 248 Mich App 346, 350-351 (2001), *Neal v Oakwood Hosp Corp*, 226 Mich App 701, 716 (1997).

Social or economic legislation is reviewed under the "rational basis" test. *Neal, supra*; *Wysocki, supra* at 354. Under this test, a statute will be upheld if the classification scheme is rationally related to a legitimate governmental purpose. *Doe v Department of Social Serv*, 439 Mich 650, 662 (1992).

Under the rational basis test, legislation is presumed to be constitutional. The party challenging the statute has the burden of proving the legislation is arbitrary, and thus irrational. *People v Pitts,* 222 Mich App 260, 273 (1997). State legislatures have a wide range of discretion in establishing classifications in the exercise of their powers to regulate. *Fox v Employment Sec Comm*, 379 Mich 579, 588 (1967) (opinion of T.M. Kavanaugh, J.).

Under established rules of statutory construction, courts have a duty to construe a statute as constitutional unless unconstitutionality is clearly apparent. *Wysocki, supra*, 248 Mich App, at 355. The party challenging the constitutionality of an act must establish that no set of circumstances exist under which the act would be valid.

The rational basis test does not measure the wisdom, need or appropriateness of legislation. *People v Pitts, supra* at 273. When a statute is challenged under Equal Protection, a court should consider the provisions of the whole law, as well as its object and policy. A rational basis exists when the legislation is supported by any state of facts either known or that could reasonably be assumed. *Neal v Oakwood Hosp, supra*, 226 Mich App at 719.

Federal courts have established similar principles governing application of the rational basis test. For example, in *Hadix v Johnson*, 230 F3d 840, 843 (6th Cir, 2000), the Sixth Circuit stated that a statute will be afforded a strong presumption of validity and must be upheld as long as there is a rational relationship between the disparity of treatment and

some legitimate government purpose. The government has no obligation to produce evidence to support the rationality of its statutory classifications and may rely entirely on rational speculation unsupported by any evidence or empirical data. *Id.*, quoting *FCC v Beach Communications, Inc*, 508 US 307, 315 (1992). Appellants bear the heavy burden of "'negativing every conceivable basis which might support [the legislation], . . . whether or not the basis has a foundation in the record.'" *Id.*, quoting *Heller v Doe*, 509 US 312, 320 (1993).

The rational basis test affords wide latitude to social and economic legislation. "'The Constitution presumes that even improvident decisions will eventually be rectified by the democratic process.'" *Olympic Arms v Magaw*, 91 F Supp 2d 1061, 1071 (ED Mich, 2000), quoting *City of Cleburne v Cleburne Living Ctr*, 473 US 432, 440 (1985).

Rational basis is a deferential review. *Breck v State of Michigan*, 203 F3d 392, 395 (CA 6, 2000). The courts need only find "plausible reasons" for the legislative action. *Olympic Arms, supra* at 1072, quoting *FCC v Beach Comm, supra.* Whether the identified legitimate State interests were actually considered in establishing the regulation is irrelevant. Whether the Legislature was "'unwise in not choosing a means more precisely related to its primary purposes is irrelevant.'" *Breck, supra* at 396, quoting *Vance v Bradley*, 440 US 93, 109 (1979). Statutory classifications will be set aside based on Equal Protection only if no grounds can be conceived to justify them. *Olympic Arms, supra* at 1072, quoting *McDonald v Board of Election Comm'rs of Chicago*, 394 US 802, 809 (1969). Whether or not the "ends" proffered by the government in support of the statute are actually those implicitly intended by the Legislature is of little consequence so long as they are plausible. *Olympic Arms, supra* at 1073.

In determining whether legislation has a rational basis, the court does not question the wisdom of the legislation. Nor should the court substitute its conception of sound public policy for that of the Legislature. If there is a rational basis for the legislation, some imperfections and inequalities will be tolerated. *Olympic Arms, supra* at 1075, quoting *Dillinger v Schweiker*, 762 F2d 506, 508 (CA 6, 1985). Further, a classification does not fail rational-basis review because it in practice results in some inequality. A statute is not invalid under the Constitution because it might have gone further than it did or because it may not have succeeded in bringing about the intended result. *Olympic Arms, supra* at 1073, quoting *Benjamin v Bailey*, 234 Conn 455; 662 A2d 1226, 1238 (1995), and *Roschen v Ward*, 279 US 337, 339 (1929).

B. The September 24, 1996 date utilized in § 205(3) was necessary to accomplish the goals of the statute.

In *Deepdale Memorial Gardens v Administrative Secretary of Cemetery Regulations*, 169 Mich App 705 (1988), the court addressed an Equal Protection challenge to a Michigan statute which prohibited a cemetery owner from owning or managing a funeral establishment. The court found there was an ample rational basis for the regulation because "competition in the cemetery and funeral businesses was preserved by prohibiting one agency from both owning and operating a cemetery and acting as a mortician." *Deepdale*, 169 Mich App at 713. By analogy, the Legislature here could have rationally and legitimately concluded that it wants to achieve two goals with § 205(3): (1) allowing wine wholesalers to be ADAs so that the State, spirits suppliers and spirits retailers, had access to a sufficient number of ADAs to make privatization work, and (2) preserving a viable, competitive wine wholesaler network that ensures that wine suppliers and wine retailers

could be serviced by a number of wholesalers, just not those few wine wholesalers who were also ADAs. This benefits suppliers, retailers and the consuming public by making sure that there would be competition at the wholesaler tier and promotes market entry for new brands.

Michigan courts have addressed the issue of whether the effective date of a statutory regulation violates Equal Protection. In *Park v Lansing School Dist*, 62 Mich App 397 (1975) (a case similar to this one), the court addressed a Lansing School District policy adopted in 1969 which required administrators to live within the District or suffer loss of their administrative positions. The policy contained an exception for those who had held administrative positions since July 1, 1962. The policy was adopted in 1969, but the policy referred to a July 1, 1962 date. The court found the grandfather clause did *not* violate Equal Protection:

> "Those hired after July, 1962 knew what was expected of them in terms of residence. The allowance made for a certain few administrators can be explained as coming from a desire to accommodate the interests of those administrators who had established themselves outside the district before the policy of in-district administrators was brought up. . . . [Those challenging the legislation] must show that the rule extends a privilege to 'an arbitrary or unreasonable class', *Alexander v Detroit*, 392 Mich 30, 36; 219 NW2d 41 (1974), and that there is no conceivable set of facts that can justify the distinction made in the rule. *Forman v Oakland Co Treasurer*, 57 Mich App 231; 226 NW2d 67 (1974). This has not been done. We are unwilling to say that the rule's cutoff date is wholly without supporting reason."

The distribution of liquor is highly regulated by the Legislature and Liquor Control Commission pursuant to the authority of Mich Const 1963 art 4, § 40, so finding a violation of the rational basis test is even more difficult in this context.

All courts that have addressed the issue have recognized that a three-tier distribution system for distribution of alcoholic beverages like wine is "unquestionably legitimate" and furthers State goals like orderly markets, tax collection, avoidance of virtual integration between suppliers and retailers and diversion of alcoholic beverages. The statutory scheme challenged here is clearly rationally related to that State interest in maintaining a viable, strong three-tier distribution system for wine, which the Legislature long ago concluded was in the best interest of the State and the public. See e.g., MCL 436.1305(1).

Contrary to the arguments made by appellants, § 205(3) is a "grandfather clause" which merely preserved the *status quo* of wine distribution rights in some territories for some brands while, at the same time, placing "dualing" restrictions on all wine wholesalers who chose to become ADAs. That is, § 205(3)'s dualing limitations recognized equity and reliance in already established distribution rights, but limits further dualing beyond those in existence on September 24, 1996 for ADAs who are also wholesalers.

Section 205(3)'s restrictions do not foreclose any wholesaler or any ADA/ wholesaler from competing for new brands or brands that were not dualed in September of 1996, or from buying an existing wholesaler and distributing its pre-September 1996 products even on a dualed basis. The Legislature obviously thought this would foster a strong and viable three-tier distribution system, where there would be sufficient ADAs and wine wholesalers vying in the market place to give beverage suppliers, retailers and consumers a meaningful choice.

The Legislature decided to utilize the September 24, 1996 date for the very practical reason that if that date was not contained in the statute, there would have been nothing to

stop wholesalers who believed that they were going to be appointed as ADAs from going to suppliers in late 1996 and being dualed prior to the effective date of the statute.

Contrary to the argument made by appellants, the inclusion of the September 24, 1996 date in the statute worked more of a hardship on then-existing wine wholesalers (who were forced to give up a right they previously had of being appointed on a dualed basis) who were going to become ADAs and limited their future ability to become "dualed."[28] By choosing the date selected, the Legislature wanted to acknowledge existing distribution rights that had already been developed through the efforts of individual wholesalers, but restrict certain distribution rights for any wholesaler who might also become an ADA and who could then gain brand distribution rights, not through their own efforts and work, but merely through their role as ADAs, with its State guaranteed income and access to retailers.

Appellants are extremely disingenuous when they unconvincingly claim that they are "effectively" kept out of the wine wholesaler market. To begin with, the prohibitions in § 205(3) only applies to *particular* limited geographic areas and *particular* brands that were being distributed on or before September 24, 1996, and that restriction does not apply to any brands of wine that were not being distributed at that point in time.

The record indicates that new wine brands are continually being offered in Michigan. *See* affidavit of Julie Wendt (MB&WWA Appendix, p 22b), where she attests that there are 20,000 brands of wine registered in Michigan for resale and of the 300 licensed out-state sellers of wine, approximately 143 licenses have been issued since September 24, 1996.

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[28] Actually appellants cannot rightly claim harm from selection of this date since they were not seeking to become a wholesaler at the time of adoption and did not become a wholesaler until 1999.

New wine suppliers and wine brands are continually coming into the market and are available to appellants if they want to work (just like all other wholesalers) to establish a brand presence rather than to merely piggy back or "free ride" on their role as an ADA. However, appellants have obviously opted to put their energy into acting as an agent of the State where they control 50% of distribution. And, nothing prohibits appellants from purchasing existing pre-September 24, 1996 distribution rights from other wine wholesalers as a way of entering the market and distributing.

The reasonable restrictions placed on appellants are placed on everyone who is both an ADA and wholesaler and does not give rise to a valid Equal Protection claim. The State's actions are rationally related to the State's interest in having spirits distributed for the State by ADAs and at the same time maintaining a strong, viable wine distribution system with a number of privately owned wholesalers to ensure competition and service to all suppliers, retailers (large and small) and the public.[29]

Appellants have not met the heavy burden of demonstrating that § 205(3) violates the Equal Protection clauses of the federal and State constitutions.

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[29] *See* Appellants' Appendix, Lashbrook Aff., p 52a, ¶ 24, where he notes that if there are not a variety of wholesalers, an ADA/wholesaler can "cherry pick" the most lucrative retail outlets (*e.g.*, large retail chains) and ignore the smaller retailers to the detriment of the retailers and consumers.

CONCLUSION AND RELIEF REQUESTED

Appellants claims of dormant commerce clause and equal protection violations are in error. MB&WWA respectfully requests that this Court affirm.

Respectfully submitted,

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